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Neilson, Jason A.

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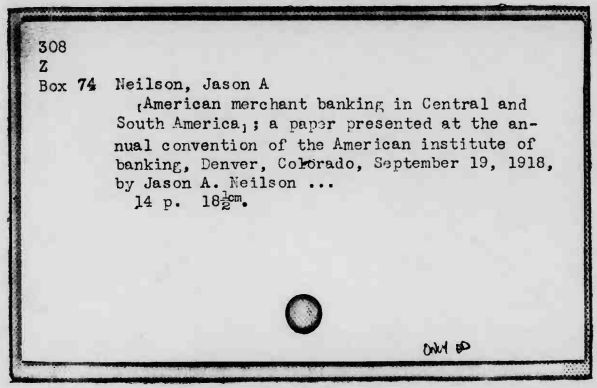

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American Merchant Banking

in CENTRAL *and* SOUTH AMERICA

A paper
presented at the
Annual Convention
of the
AMERIÇAN INSTITUTE
of BANKING
Denver, Colorado
September 19, 1918

BY
JASON A. NEILSON
VICE-PRESIDENT
MERCANTILE BANK *of the* AMERICAS
Incorporated
NEW YORK

6 April, 1920 - C.R.W.

American Merchant Banking *in* Central *and* South America

During the last few years considerable trade has sprung up between North and South America, no doubt in a great measure due to the conditions prevailing in Europe, which forced the Central and South American countries to trade with the North American Republic. It is the hope of those interested in foreign trade that the result of this necessity will be that our friends in the South will have learned to like us to such an extent that even after the markets of the world are re-opened, they will see the advantages of continuing to do all they can with their neighbors in the North. On the other hand, it is unquestionably true that we have been learning rapidly and that we shall be able to render service to our friends in the Republics to the South, that will be far superior to that which we have been giving them heretofore.

Given a condition where mutual faith exists, and where there seem to be many things for groups of men to work for in common, as we now have in the situation existing between the North American Republic and its neighbors, besides proper transportation facilities, we shall require machinery that will constantly be at work, bringing buyers and sellers together on the right basis. Foreign Trade and Foreign Banking must go hand in hand, and there is no better instrument known to civilization for this service than the proper sort of a bank. It would be foolish to say that before the European war, there were no banking facilities to take care of the limited business between the Republics. Our English friends

supplied in a great measure the banking facilities whenever the Republics desired to do any business other than could be done with England. Of course, they naturally favored the trade of their own country, and through their great merchant houses in South and Central America, backed by their banks in those countries, and the representatives of the merchant houses of the banks located in the United States, such trade as was done between the Republics was taken care of. In a general way, the same remarks apply to the German commercial organization, although the business was done in quite a different way.

At this time we are especially interested in any method which will permit us to do the trading ourselves, which the Germans have heretofore done for us. A passing glance at the system established by Germany in the South American countries might therefore be interesting. Under their plan, young men were sent to South America, after having studied in commercial schools and receiving a preliminary training in the merchant or banking houses of Bremen or Hamburg. In some cases they were set up in business under their own names, but in reality they acted for account of banking interests. In many cases they married and apparently made up their minds to stay in the Latin American country for the rest of their lives. This gave them quite some power through family relations. The German banks were established in those countries by the same banking interests. In turn the same banking interests had their connections with the international transportation facilities, and the same interests had virtual partnerships, in so-called "commission or merchant banking houses" established in the United States. The chain was thus complete, and every North American transaction passing through the machine paid tribute to German banking interests. This illustration will serve to show in a measure how thoroughly the Germans had established their trade, and also to give one an insight into the difficulties of overcoming this situation in the course of a few years.

The Republic of North America has seen this situation growing for some years, but her people were not inclined to enter foreign trade to any great extent, because of the broadness and the pressure of the home market, which consumed all the country could manufacture. The events of the war and the rapid development in her own land, have however now partially awakened her and she sees to some degree the need for foreign trade in order that the men who will return and work in her shops after the war, may be kept employed, and in order that she may continue to grow onward and upward and be as prosperous as heretofore.

The pressing question before the North American Republic is how best to enter the foreign trade field, and how to keep the trade. She knows that it is a stern chase for her. The other commercial nations of the world have been training men for years, and their merchants are more largely given to world trading than those of the United States. They know the customs and the goods needed, and give their foreign trade just as good service as their domestic trade. On the other hand with few exceptions, the direct foreign trade of the manufacturers of the United States has been confined to the large producers. The medium sized manufacturer does not seem to be ready to act. That is, it seems that he is not ready to take as much trouble to establish direct relations in a country like Peru, as he would to establish direct relations in say the State of Iowa. It is not our function, however, to comment to any extent here, upon the foresight and enterprise, or lack of it on the part of the ordinary North American merchant, in connection with foreign trade. It is quite enough that we bankers analyze our own profession and see if we are doing our part to be ready when the time comes.

For a number of years the matter of American banks in foreign countries has been constantly discussed in conference and elsewhere. A knowledge of our shortcomings in respect to foreign trade and foreign banking, has been spread broadcast through the country. The

result of this action has been the development of an intense interest among a large part of the people, and when this occurs in the United States there is a good chance that the people will rapidly correct their faults. To no part of the world have the minds of the people of the North American Republic turned with such interest as to Latin America. Spanish is probably the favorite foreign language being taught in these days for trade purposes. It is being studied in every hamlet. The people of North America, taken as a whole have been provincial up to their entrance into the war, but they learn quickly, and after the war there will be thousands of men who will take up foreign trade and foreign banking as their profession. The Federal Reserve Act has made very good provisions for these relations, and it remains for the bankers of America to make the dream a reality. To that end a number of banking groups have been working. Of course, there is not room in many of the Latin-American Republics for the establishment of more than one American Bank for foreign trade. The unfortunate part of all efforts to promote foreign trade abroad, will be that American Bankers will persist in unduly duplicating facilities, and will fight each other instead of presenting a solid front to competitors. It is hoped that some way will be found to conserve our financial resources along this line through co-operation.

In the meanwhile the following may be said to represent the principal classes of banking thought in respect to Central and South American foreign trade and banking.

(1) Banks of deposit and discount in the U. S. A. which practice the system of establishing their own branches.

(2) Foreign trade banks which take no deposits in America, but also practice the system of establishing their own branches.

(3) American banks of deposit and discount which claim there is really no need for them to establish their own branches, or to participate in the

ownership of a foreign trade bank, because they find it profitable to deal through European and local banks established in those countries, which banks reciprocate by keeping balances and buying dollar acceptances from them.

(4) Foreign trade banks which take no deposits in America, and believe that whenever possible there should be a local bank established in each country under joint North American and local management, but under stock control by the North Americans, because of the fact that they furnish the credits and capital.

There are arguments to be made in favor of each system. Perhaps in one place one system would be the best, and in another the opposite system would produce satisfactory results. The question of system, however, is of little importance. The great question is power to render service, and to deserve the good will and patronage, and to work co-operatively with our neighbors.

As the branch system for member banks has been fully dealt with by various people in the past, it is not necessary for us to dwell upon it here. We shall, therefore, give special attention to the foreign trade banks formed by joint action of a number of independent institutions, inasmuch as this phase has not been dwelt upon to any great extent heretofore.

The first operating organization along this line in America was the Mercantile Bank of the Americas, established in August, 1915. The second was the American Foreign Banking Corporation, which was established two years later. The latter has so far, apparently adopted the branch bank system, which subject is covered by the remarks applicable to national banks, which have established a similar system. One of the differences, however, is that the branches of the American Foreign Banking Corporation are established by joint action of a number of banks. Neither of these foreign trade banks receive local deposits in America, and therefore, they do not in any way use the foreign trade business that may come

to them as a means to obtain local deposits in America. To do this, of course, is a perfectly legitimate action on the part of any American bank of deposit and discount which has its own branch in a foreign country, but banks which have no foreign branches and which have accounts of American manufacturers and exporters do not care to lose part of their balances and therefore most of them look with favor upon this feature of the foreign trade banks. Thus by refraining from accepting local deposits in America, the two foreign trade banks mentioned are in a favorable position to clear the foreign business and to be freely consulted by banks and their clients. Both foreign trade banks operate under direct supervision of the Federal Reserve Board at Washington, and banks throughout the country have become shareholders whenever they had enough business to warrant it.

Separate American banks for each country in Central and South America is the system generally followed by the Mercantile Bank of the Americas. They have adopted that system believing that as most of the Latin-American countries differ from one another in respect to currency, banking laws and customs, a separate and specially equipped bank would better meet the local conditions which prevail in most countries. Each of these banks operate only in one country; it is a local bank of deposit and discount. It publishes a separate statement of its own and is to all intents and purposes exactly like other local banks, with the exception that it is possible for the North American organization to give such a bank much greater support than would be possible, were it purely a local institution owned by local capital, or by non-American interests and consequently without any control on the part of the bankers of North America.

Having established such a bank, the next question is how to operate it; to promote trade between the countries interested; and at the same time make the bank a profitable institution. In all countries where capital is scarce, there are few deposits and banks are therefore primarily lenders of credit, which they obtain through loans secured

in other countries which have capital. Therefore, deposits are not very heavy and cannot be counted upon as a source of much revenue. This is naturally true where money is worth from 8 to 12 per cent. On the other hand, these rates are not as attractive as they look. Overhead charges are extremely heavy and losses far exceed those experienced in a country where capital is more plentiful.

Bearing in mind the system of the Germans and others, and by analysis reducing the business as conducted by them to its elements, it is found that the undeveloped countries to the south contain just the same factors as the undeveloped and under-capitalized sections of our North American Republic. In the early days, we needed a close and intimate connection between the movements of goods and banking. This class of business was called "merchant banking" by some. It is still practiced to some degree in the United States and is common everywhere outside of the United States. The American local banks established by the Mercantile Bank of the Americas in the countries of Central and South America practice merchant banking, in addition to their ordinary functions in handling local deposits, discounts and negotiable instruments and exchange generally. As mercantile banks they will do anything possible through their foreign trade departments to bring buyer and seller of the countries together. It should be clearly understood, however, that these banks do not trade, that is, they do not take a position or a market risk in merchandise. They merely act as an intermediary, between buyer and seller and receive a commission for services rendered.

The operations of these American merchant banks in South and Central America, in respect to the shipment of raw materials to the United States, can perhaps best be illustrated by the following: In the old days in our Southern states a planter of cotton in Louisiana would borrow from the "factor" in the neighboring town enough money to pay for his fertilizer, seed, and often for his labor in growing and picking the crop. The "factor"

often was the owner of a cotton gin in the neighboring small town, and when he provided the farmer with money he made an arrangement with him, whereby the farmer agreed to forward his crop through him to the ultimate market. The "factor" then would borrow from the small bank in his town; the bank in turn would borrow from the neighboring city of New Orleans; New Orleans would borrow in New York, and in order to relieve the pressure upon the New York money market, private bankers and some of the trust companies would draw their sixty or ninety days sight drafts on London, thus borrowing funds in the English market.

When the cotton was picked and put through process, the "factor" would look around and find a buyer through the ordinary broker or dealer; his loan with the bank in his town would be liquidated by proceeds of the sale of the shipper's draft, which was usually on Liverpool, at 60 days sight. This draft was sold to the bank in New Orleans; the New Orleans bank in turn would sell the draft to New York; and New York bankers who had issued their own 60 or 90 days sight bills several months before would cover their maturing obligations in London, by remitting the cotton bill.

The elements contained in the above transaction apply to Latin-American countries producing, say, coffee, and the operation of our merchant banking facilities in South and Central America is somewhat along these lines. These systems are those practiced by the Germans and other non-American bankers and merchant bankers in those countries, and the elements contained therein must be matched by us, even if dressed differently, if we are to have successful American banks abroad and if we are to win in our efforts to gain the good will and trade of our neighbors. In other words, if we are to sell them our manufactured goods, we must finance their produce just as other nations do.

The local bank established in the country makes loans to the coffee planter, and in turn the coffee planter gives it his crop as collateral for the loan as soon as produced.

It will be noticed that the bank thus retains control over its collateral until it is disposed of in the consuming market through the regular dealers, the cash received, and the loan liquidated.

As collateral loans enable the banker to safely give larger lines of credit than he could possibly grant on unsecured loans, this phase of merchant banking as practiced in Latin-American countries is a great advantage in the less highly developed countries where liquid capital is scarce and the wealth of the people consists in the main of plantations and their auxiliaries.

In dealing with the raw products received from South America, it will have been noticed that the North American Bank only disposes of the raw materials in the North American market in its capacity as representative of the South American producer, and to obtain funds to liquidate advances made in Central and South America. The contra is true of the South American bank in its services to the North American exporter or manufacturer. Because of intimate local connections, these merchant banks established in each country, are in a most favorable position to aid North American manufacturers in extending the market for their goods and in bringing buyers and sellers together. They do everything that a bank can reasonably be expected to do in extending and financing North American export trade. They give the most intensive service to the representative of any North American manufacturer or exporter endeavoring to sell goods. Before he visits a prospective client, they see that he is properly and personally introduced by the right person, seeing also that he does not visit people to whom goods can not be safely sold from the viewpoint of credit. They recommend to the North American manufacturer that he establish his own direct relations between buyer and seller, giving the trade of the Central and South American countries just as much attention as he does the trade of one of our own states on the North American Continent. Under proper direction the manufacturer can safely grant credit just as he does here, and his local

bank, with the aid of the Foreign Trade Bank, can take care of him. The credit granted by the merchant may be checked by the American bank on the ground, just as the merchant's own credit man at home would do. This is far more satisfactory in Latin-American countries than action upon the reports that will be given from various sources, including banking sources, however good they may be. Sometimes the American bank abroad could intervene by granting the purchaser of the goods in the Latin-American country, credit, wherewith to buy the goods, or the Foreign Trade Bank might guarantee the account for a commission. Consignments can be made to the American bank abroad by the American manufacturer, in large lots, which can be kept under control of the bank in warehouse, advanced against, and released as the manufacturer's or exporter's agent disposes of the goods. Markets may be searched by experts for materials needed in North America and the same research may be made to see whether or not a line of North American manufactured goods would be suitable for the Latin-American country under consideration. Consultation with men with long experience in banking and trade in the various countries can be arranged either for themselves or for their clients, by North American banks which are in touch with the foreign trade banks.

At places where these merchant banks have been established for any length of time, arrangements have been completed, or are under way, whereby in a building adjoining the bank, or in the bank building itself, space is set aside to be used by the representatives of American manufacturers and for exhibition of North American goods. Such banks have foreign trade departments with men trained in merchandise, who co-operate with the representative in any manner desired.

It is worth noticing that these local banks have started in the South and Central American countries by making loans in an ordinary way, in fact they are local banks to all intents and purposes. They enter very closely into the life of the people, becoming the exclusive bankers of

most of their clients, and in that way if North American manufacturers have goods that are satisfactory to the people, and can produce them at the right prices, the good-will that these local American banks obtain by serving the peoples of South and Central America can be availed of by the American manufacturer and exporter to the fullest extent.

It would seem that with facilities such as these at their command, enterprising exporters and manufacturers in this country should take immediate steps to plan for the conditions that probably will come to pass as soon as the war is over. It is very likely that the great manufacturing organizations being built up or expanded for the manufacture of war materials will have to be used for the manufacture of ordinary articles of commerce. Perhaps many of the men coming back from the war will flock to the cities, and it may become more and more necessary for us to have an outlet for manufactured goods. In that event it would seem that a great deal may be said for an American banking system that cultivates the good-will of the people of the Latin-American countries, by virtually going into partnership with them and having banks established in each country, which bear the name not only of the country in which they are established, but also bear the name "American."

The duty of the American domestic banker in connection with foreign trade is no small one, and he can be an important factor in developing the business of his clients if he wishes to do so. Very little training is necessary. All the domestic banker has to do is to know where to go to obtain good advice and service. The facilities mentioned are at the full disposal of all independent banks throughout America.

The facilities heretofore offered to the clients of the banks of our country have been fully exploited in their advertising, and the added facilities for foreign trade now available furnish new advertising talk for the banks in the solicitation of business. Arrangements can be made whereby they can command the services of these American

banks abroad if desired, communicating with them direct, and receiving as good service as their own branches abroad could possibly render.

If one man in each bank is directed by his officers to make it his business to know how to advise with manufacturers, a good step forward will have been taken. The day has gone by when any progressive bank of deposit and discount, having manufacturers or exporters as clients, can afford to ignore the trend of the times toward sales of our manufactured products abroad, and the service to be obtained through the two foreign trade banks which do not solicit local deposits would appear to be worthy of careful consideration in this connection.

Denver, September 19, 1918.

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